

Sir Isaac, the Bubble Boy

One reason to read history is to overcome the satisfied feeling that we have everything figured out now. History tells us that, despite the relentless advance of science and technology, human nature is something of a constant. Without this context, it is too easy to scoff at the seeming insanity of, for example, the widespread belief that the world would end in the year 1000 or the Dutch speculation in tulip bulbs in the 17th century.

Many histories of financial speculation judge the foolishness of past investors with the detachment of a hiker kicking over an ant hill and watching the result. The common assumption that there was no reality behind the manias isn't always accurate. Consider the wealth of the New World of America from a European perspective. In 1720, both France and England went through speculative booms and busts in government schemes to sell monopoly rights to natural resources or trade in America. The motivation of the governments was to use the proceeds to pay off burdensome debt incurred in the War of the Spanish Succession. The French and English stories are very similar; let's focus on England.

***"The same thing happened today
that happened yesterday,
only to different people "
-- Walter Winchell***

In 1711 Robert Harley, the leader of the Tory Party, set up the South Sea Company. The South Sea Company was a joint stock company with transferable shares, a relatively new idea at the time.

Harley enlisted the efforts of skilled public relations writers to increase interest in the shares, including Daniel Defoe (*Robinson Crusoe* and *Moll Flanders*) and Jonathan Swift (*Gulliver's Travels*). While hoped-for trade concessions from Spain never occurred, the British government, eager to retire debt, encouraged speculation in the shares of the South Sea Company (purchased by turning in government bonds) and similar ventures. Official favor of the venture was enhanced by issuing free stock to government ministers and legislators. South Sea Company shares increased more than eight-fold between January and June 1720.

The irritating notion that others were getting rich fast (sound familiar?) brought more and more speculators into the market for trading joint stock shares. The new joint stock companies caught the public imagination and 1720 saw a tremendous speculative boom in companies investing not only in the New World but in other ventures as diverse as building hospitals for illegitimate children and insuring horses. The reckoning came in September when share prices returned to January levels. Since a significant amount of speculation in the shares was financed by credit, several thousand speculators were bankrupted.

As is often the case after a financial "readjustment," speculators found it easier to blame others rather than themselves. A hunt for villains ensued, with at least one prominent backer of the Company committing suicide and several others jailed and fined. The next 50 years in Britain were colored by memories of the financial disaster, with Parliament refusing to authorize additional joint stock companies. It wasn't until the industrial revolution (and publication of *The Wealth of Nations* by Adam Smith in 1776) that business affairs could again be venturesome.

Despite the participation of Defoe and Swift, it may seem easy to dismiss speculators in the bubble as foolhardy. But are the South Sea speculators so different from some New Era speculators today? Perhaps the most notorious venture in the South Sea Bubble described its business plan as follows: "for carrying on an undertaking of great advantage, but nobody to know what it is." In our new age of enlightenment, Amazon.com regularly surprises its shareholders by announcing new business lines. (Hey, now we're selling garden tools!)

***Experience is something
you don't get until
just after you need it***

The exploration and exploitation of the New World was a tremendous positive economic force in Europe, and yet many if not most speculators in the South Sea and Mississippi Bubbles lost the bulk of their investment. The Internet is a tremendous positive economic force in the world economy now, but that doesn't mean it results in automatic wealth for "investors" in the boom. Of 377 Internet stocks tracked by Morgan Stanley Dean Witter, almost half were recently below their IPO price and the average stock is down two-thirds from its 52-week high. Making successful speculation even more difficult, the worst performing Internet stocks are, for the most part, the ones you were most likely to have invested in, the big name companies in e-commerce and content. The best performing stocks were unfamiliar Internet infrastructure companies speculators were less likely to have found.

If you still think you are wiser than those foolish speculators in the South Sea Bubble, consider Sir Isaac Newton, master of the English mint in addition to his scientific endeavors. Isaac doubled his money in the first stages of the boom, but greed got the better of him and he wound up losing almost six times what he initially invested, more than the current equivalent of a million dollars. We're all pretty smart now, but this was a guy who sat down with a quill pen and cranked out the laws of motion and gravity and invented the calculus. His take on the Bubble? "I can calculate the motions of the heavenly bodies, but not the madness of people." If you doubt you are smarter than Sir Isaac and want some help with your investments (without musings on the motions of heavenly bodies), contact us.